

## Message Text

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ORIGIN SS-25

INFO OCT-01 ISO-00 SSO-00 /026 R

DRAFTED BY EB/IFD/OMA:BGCROWE  
APPROVED BY EB/IFD:CFMEISSNER  
NEA/PAB:HLUSIUS  
P - TMILLER

-----066839 081646Z /41

O 081624Z JUL 78

FM SECSTATE WASHDC

TO AMEMBASSY TEHRAN IMMEDIATE

AMEMBASSY ISLAMABAD IMMEDIATE

C O N F I D E N T I A L STATE 172804

STADIS//////////

EXDIS

E.O. 11652: GDS

TAGS: EFIN

SUBJECT: THE IRANIAN-GUARANTEED COMMERCIAL BANK LOAN TO  
PAKISTAN

THE FOLLOWING COPY OF A BACKGROUND PAPER ON THE ISSUE OF  
THE IRANIAN-GUARANTEED COMMERCIAL BANK LOAN TO PAKISTAN  
PREPARED FOR UNDER SECRETARY NEWSOM IS PROVIDED FOR YOUR  
INFORMATION.

BACKGROUND:

OVER THE PAST TWO YEARS THERE HAVE BEEN FREQUENT DIS-  
CUSSIONS BETWEEN PAKISTAN AND A SYNDICATE OF PRIVATE BANKS  
(LED BY CITIBANK) REGARDING THE POSSIBILITY OF A \$300  
MILLION COMMERCIAL BANK LOAN. SUCH A LOAN WOULD CARRY A  
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MATURITY OF 6 OR 7 YEARS AND BE GUARANTEED BY IRAN. THE  
LOAN WAS DELAYED BY PRIVATE BANK CONCERN REGARDING THE  
POLITICAL/ECONOMIC UNCERTAINTIES AFFECTING PAKISTAN AND BY  
THE DIFFICULTIES OF WORKING OUT THE TECHNICAL ASPECTS OF  
SUCH A LOAN. IN THE INTERIM, PAKISTAN BEGAN TO ACCUMULATE  
SHORT-TERM (1 YEAR OR LESS) DEBT AS A SUBSTITUTE FOR THE  
REQUIRED FINANCING.

IN RECENT MONTHS, IT APPEARS THAT THE GOP HAS ENERGETICALLY PURSUED THE GOI ON THE \$300 MILLION LOAN, BUT THAT THE GOI HAS BEEN COOL, APPARENTLY HOLDING UP A DECISION PENDING RESOLUTION OF THE BHUTTO CASE. HOWEVER, THERE HAS BEEN A SIGNIFICANT EASING OF PAKISTAN'S BALANCE OF PAYMENTS DIFFICULTIES, LARGELY THE RESULT OF SHARPLY INCREASED WORKER REMITTANCES. (FOREIGN REMITTANCES ROSE FROM \$600 MILLION IN PFY 77 TO ROUGHLY \$1.2 BILLION IN PFY 78.) THE IMF STANDBY BEING NEGOTIATED BETWEEN THE FUND AND THE GOP REFLECTS THE NEED TO LIMIT THE CONTRACTING OF NEW DEBT. THE LETTER OF INTENT CURRENTLY BEING REVIEWED BY THE GOP WOULD PROHIBIT DEBT WITH A MATURITY OF UNDER 5 YEARS (LOANS FOR FOOD IMPORTS ARE EXEMPTED), AND RESTRICT THE CONTRACTION OF OTHER LOANS WITH A MATURITY OF LESS THAN 15 YEARS. ACCORDING TO IMF STAFF, THE \$300 MILLION COMMERCIAL LOAN WOULD BE PROHIBITED IN THE NEW STANDBY AS NOW DRAFTED.

PAKISTAN WAS DISAPPOINTED BY THE RESULTS OF THE JUNE MEETING OF THE IBRD AID-CONSORTIUM, PARTICULARLY ON THE CONSORTIUM CREDITOR POSITION THAT PAKISTAN'S IMPROVED PAYMENTS OBIATED THE NEED FOR DEBT RELIEF AT THIS TIME. THE GOP SEES ITSELF ON THE THRESHOLD OF REQUIRING CONSIDERABLE FOREIGN EXCHANGE TO COVER UNEXPECTEDLY HEAVY IMPORTS--  
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APPROXIMATELY TWO MILLION TONS OF WHEAT -- OVER THE NEXT 12 MONTHS. (CONSORTIUM CREDITORS RECOGNIZED THE UNCERTAINTIES IN PAKISTAN'S PAYMENTS POSITION AND PROMISED TO KEEP THE NEED FOR DEBT RELIEF UNDER REVIEW.) THE GOP HAS ADVISED THE IMF THAT IT IS UNDERTAKING A REVIEW OF ITS INTENDED STANDBY COMMITMENTS IN ORDER TO MAKE WHATEVER ADJUSTMENTS MAY BE NECESSARY GIVEN THE OUTCOME OF THE CONSORTIUM MEETING. IT IS POSSIBLE THAT THE GOP MAY CONCLUDE THAT THE IDEA OF THE \$300 MILLION LOAN SHOULD BE RESURRECTED. THE PRIVATE BANKS, HOWEVER, BELIEVE THE ISSUE TO BE DEAD AND WILL NOT SHOW ANY ENTHUSIASM FOR THE IDEA UNTIL SUCH TIME AS IRANIAN INTENTIONS CLARIFY.

PAKISTAN'S ECONOMIC SITUATION AND PROSPECTS DO NOT JUSTIFY ANY SUBSTANTIAL ACCUMULATION OF COMMERCIAL DEBT. IT IS CLEARLY AN ECONOMY WHICH SHOULD RELY ON CONCESSIONAL ASSISTANCE TO THE MAXIMUM EXTENT POSSIBLE. THE ONLY POTENTIAL BENEFITS OF A COMMERCIAL LOAN AT THIS TIME WOULD BE IF IT WAS USED EITHER TO PAY OFF OUTSTANDING SHORT-TERM DEBT OR TO SUBSTITUTE FOR THE HARDER-TERM LOANS (SUCH AS CCC) WHICH THE GOP MAY UNDERTAKE. IN ANY CASE, PAKISTAN'S AT LEAST TEMPORARILY IMPROVED PAYMENTS POSITION AND IMF

EFFORTS TO RESTRICT RELIANCE ON COMMERCIAL BORROWING ARGUE  
STRONGLY AGAINST ANY USG EFFORTS TO ENCOURAGE IRANIAN  
PARTICIPATION IN THE LOAN AT THIS TIME.

OTE: THE FIRST INSTALLMENT (\$85 MILLION ) ON A \$580  
MILLION 1974 IRANIAN LOAN TO PAKISTAN WAS SUSPENDED (BUT  
NOT CANCELLED) BY IRAN. IT WAS ALSO EXPECTED THAT THE  
SECOND PAYMENT (ALSO \$85 MILLION ) DUE JUNE 30, 1978,  
WOULD ALSO BE SUSPENDED. THE IRANIANS HOPED THE IBRD  
CONSORTIUM CREDITORS WOULD AGREE TO DEBT RELIEF AT LAST  
JUNE'S MEETING, AND IT IS NOT CLEAR IF ADDITIONAL PAYMENTS  
TO IRAN WILL BE SUSPENDED IN THE ABSENCE OF SIMILAR RELIEF  
BY CONSORTIUM CREDITORS. (PAKISTAN'S DEBT TO CONSORTIUM  
CREDITORS HAS BEEN EXTENDED ON MUCH MORE CONCESSIONAL TERMS  
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THAN PAKISTAN'S DEBT TO IRAN. AS OF JUNE 30, 1977,  
PAKISTAN'S DEBT TO CONSORTIUM CREDITORS HAD A GRANT ELEMENT  
OF 61 PERCENT WITH THE GRANT ELEMENT ON DEBT OWED TO THE  
USG AT 64 PERCENT. IN CONTRAST, THE GRANT ELEMENT ON  
IRANIAN LOANS WAS ONLY 32 PERCENT.)

SOME REPORTS SHOW THE INSTALLMENTS AT \$58 MILLION RATHER  
THAN \$85 MILLION. VANCE

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## Message Attributes

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**Capture Date:** 01 jan 1994  
**Channel Indicators:** n/a  
**Current Classification:** UNCLASSIFIED  
**Concepts:** COMMERCIAL BANKS, COMMERCIAL LOANS  
**Control Number:** n/a  
**Copy:** SINGLE  
**Draft Date:** 08 jul 1978  
**Decaption Date:** 20 Mar 2014  
**Decaption Note:** 25 YEAR REVIEW  
**Disposition Action:** RELEASED  
**Disposition Approved on Date:**  
**Disposition Case Number:** n/a  
**Disposition Comment:** 25 YEAR REVIEW  
**Disposition Date:** 20 Mar 2014  
**Disposition Event:**  
**Disposition History:** n/a  
**Disposition Reason:**  
**Disposition Remarks:**  
**Document Number:** 1978STATE172804  
**Document Source:** CORE  
**Document Unique ID:** 00  
**Drafter:** BGCROWE  
**Enclosure:** n/a  
**Executive Order:** GS  
**Errors:** N/A  
**Expiration:**  
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**Original Handling Restrictions:** EXDIS, STADIS  
**Original Previous Classification:** n/a  
**Original Previous Handling Restrictions:** n/a  
**Page Count:** 3  
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**Secure:** OPEN  
**Status:** NATIVE  
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**To:** TEHRAN  
**Type:** TE  
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**Review Markings:**  
Sheryl P. Walter  
Declassified/Released  
US Department of State  
EO Systematic Review  
20 Mar 2014  
**Markings:** Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014